

Fellow Members,

I would like to thank all of those who provided input on the draft EMA comments to EPA on the Transport Rule (due by Sep 30.) Clearly there is concern about the Rule, particularly with respect to 1) the complexity of the limits on interstate trading and 2) the inability to carry-forward Title IV allowances. However, many of you seemed to arrived at the same place the Board has, which is that absent Congressional action to preserve Title IV, with some key modifications the Transport Rule is probably “as good as it gets” with respect to regulatory responses to CAIR vacatur.

On September 1, I presented our comments on the Transport Rule at a public hearing held by EPA in Atlanta. I appreciated the support provided by EMA Board Member Josh Hale, as well as Members Richard Taylor from Southern Company and Tom Fletcher from Mirant who also attended the hearing.

As the EMA Board, we remain focused on how best to get the modifications to the Transport Rule that preserve the continuity of allowance trading. In particular, we want to urge EPA to elect to choose to allow for conversion of CAIR NOx allowances by applying surrender ratios to banked allowances (its Option 2 from the proposed Rule.) In your comments, some members expressed the feeling that our proposal to “reverse the fuel factor allocations” in conversion was unclear, in particular that it could 1) lead to different classes of NOx allowances, or 2) be easily defeated by having companies use their banks to surrender the allowances on their behalf.

We have discussed a more specific methodology for conversion of the allowances to address these concerns. As noted by your comments, if EPA decided to convert allowances based on original allocation recipient, we would have two classes of allowances, and people would price them differently based on their eventual conversion rate. Under the methodology we discussed, we would not tie the reversal of the fuel factors to the original allowances as allocated to recipients, but by the fuel status of the holder of the allowances who offers them for conversion, i.e., no matter where they got them, a 100% coal-fired company would convert CAIR NOx allowances at some higher level (say 3.8:1) and a merchant CCGT would convert them at 1:1.

Then there is the issue of a company asking its bank (no fuel position) to convert NOx allowances on their behalf. To discourage use of non-emitting conversion proxies, EPA could require that conversion be completed in rounds, with the first round being restricted to naturals (with a definable fuel position.) Then in a successor round, EPA could stipulate that financials and other parties could convert the CAIR NOx allowances they hold at say, at the highest conversion rate applied in the first round (so parties with a fuel position would have an incentive to participate in the first round.)

After my presentation, I was asked by Sam Napolitano to “please provide as much detail as possible regarding your proposal for NOx allowance conversion.” He also reiterated his request in personal comments after the hearing. While I am not an attorney, I understand that as a matter of administrative law, it is critical for EPA to have a complete public record to cite in choosing to pursue a particular course of action. In that spirit, we would like to add a description of such the “two-round” conversion methodology discussed above to the EMA comments (see edits to the last two paragraphs of the attachment.)

No matter what EPA did in responding to CAIR vacatur, we have known all along that most of us in the industry would not be fully satisfied with the outcome. Let us work together to get the best Rule we can. Please let us know what you think promptly, so we can file comments on time next week.

Thanks for your continued support of EMA.

Thad Huetteman

Chairman,
Environmental Markets Association

DRAFT (August 12, 2010) PRIOR TO MEMBER COMMENT

The Environmental Markets Association recognizes EPA's efforts in the proposed Transport Rule to have emissions trading play a central role in the Rule, while working within the bounds of the D.C. Circuit's earlier decision.

We know that EPA recognizes that it is critical to maintain the integrity of allowances as they represent the return on emission reduction investments which underwrite the improvements in human health and air quality. EMA is glad to see that the EPA is considering three options for the convertibility of CAIR NOx allowances. Failing to convert banked CAIR NOx allowances largely eliminates the return on investment that was expected as CAIR was implemented.

We fail to understand how "cap-and-trade" policy has been diminished in public debate. EMA is the pre-eminent organization for those organizations who underwrite improved human health and air quality by creating and trading SO2 and NOx reductions. Cap & trade has for fifteen years proven essential to achieving these goals earlier and at lower cost than any other form of regulation. To fulfill our compliance obligations by undertaking these significant financial commitments, we feel it is essential for EPA to restore confidence in achieving environmental objectives that affect the well-being of every American (and indeed, the global citizenry) using a trading market where investors can receive a fair shot at a return on investment.

Without the environmental certainty of a "cap", none of us can be assured that the desired improvements in human health and air quality will be achieved. Without the regulatory certainty needed to support "trade", risk premiums for emission reduction projects go up, along with the cost of allowances - something that does not benefit the environment or consumers. Cap & trade should be about attracting capital to the highest return projects. The higher the cost of capital, the higher the cost of the projects that get completed, and the greater the resistance to further reductions.

We know that EPA understands these principles, but we think it is essential for it to take the next step and provide for continuity of current programs by providing for conversion of CAIR NOx allowances. We also appreciate that the Agency is concerned over additional litigation because CAIR NOx allowances were allocated based on fuel factors, which the Court rejected in its decision. EMA believes that EPA could provide for continuity in allowance markets by electing to apply surrender ratios to banked allowances. We suggest that it might help reduce the risk of subsequent litigation if EPA set the surrender ratios in a way that would reverse impact of the original fuel factor allocation method (e.g., if a 100% coal-fired company converted its allowances at a higher ratio than a gas-fired company.)

There are a number of issues raised by the discounted CAIR NOx conversion option. If EPA decided to convert allowances based on to original allocation recipient, we would have two classes of allowances, and people would price them differently based on their eventual conversion rate. Under the methodology we discussed, we would not tie the reversal of the fuel factors to the original allowances as allocated to recipients, but by the fuel status of the holder of the allowances who offers them for conversion, i.e., no matter where they got them, a 100% coal-fired company would convert CAIR NOx allowances at some higher level and a merchant CCGT would convert them at 1:1.

Then there is the issue of a company asking its bank (no fuel position) to convert NOx allowances on their behalf. To discourage use of non-emitting conversion proxies, EPA could require that conversion be completed in rounds, with the first round being restricted to naturals (with a

definable fuel position.) Then in a successor round, EPA could stipulate that financials and other parties could convert the CAIR NO_x allowances they hold at say, at the highest conversion rate applied in the first round (so parties with a fuel position would have an incentive to participate in the first round.)

EMA supports efforts, such as this, to promote market-based mechanisms for responding to environmental issues because emissions trading results in reducing emissions earlier and at a lower cost than any other form of regulation. We encourage EPA to maintain the continuity of existing trading programs by providing for the convertibility of current period allowances into the subsequent Trading Rule programs, and we would encourage Congress to provide EPA with sufficient flexibility in the future to avoid the problems that EPA has encountered in trying to maintain a viable emissions trading market.